SUMMARY OF INTEREST EQUALIZATION TAX AND TREASURY PROPOSAL FOR EXTENSION

PREPARED FOR THE USE OF

THE COMMITTEE ON WAYS AND MEANS

BY

THE STAFF

OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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THE TAX IN GENERAL

The interest equalization tax, first made effective in the middle of 1963 and subsequently used in conjunction with the limitations on extensions of credit and direct investments abroad, is a part of the balance-of-payments program and is designed to reduce the outflow of dollars from the United States. This is accomplished by raising the costs to foreigners of obtaining capital in the United States to levels which approximate the cost of raising capital in their own countries.

The tax is imposed on U.S. persons which acquire foreign stocks and foreign debt obligations at rates which may be varied by the President between zero and a level which is roughly equivalent to a 1½ percentage point increase in the rate of interest foreigners would have to pay to obtain funds here. The President has the authority to prescribe a lower tax rate for new issues than the rate prescribed for outstanding issues. Under present law, the maximum tax rate in the case of stock is 22½ percent. A sliding scale of maximum rates is prescribed for debt obligations, ranging from 1.58 percent for obligations with a maturity of 1 year to 22½ percent for obligations with maturities of 28½ years or more. A tax rate of 22½ percent on an obligation with a maturity of 28½ years is approximately equal to the present value of a 1½ percent annual interest cost on the obligation. The lower rates for obligations with shorter lives achieve substantially the same effect. It is expected that the tax, although imposed on a buyer or lender, generally is passed on to the seller or borrower as an additional cost which must be recovered to make the loan attractive to the buyer or lender.

At the present time, the rates of tax prescribed by the President pursuant to his authority are the equivalent of a ¾-percent annual interest cost which in the case of stock and long-term debt obligations is a rate of 11¼ percent.

TREASURY RECOMMENDATION FOR EXTENSION OF TAX

Under present law, the interest equalization tax expires as of March 31, 1973. The Treasury Department recommends that the tax be extended for 2 years or until March 31, 1975. The Treasury indicates that the tax is an essential part of the U.S. balance-of-payments program. It is understood that the Treasury will propose several other amendments in its testimony before the Committee.